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OPEN MEETING AGENDA ITEM

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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Arizona Corporation Commission
DOCKETED
AUG 3 2010
DOCKETED BY

WATER UTILITY ASSOCIATION OF ARIZONA
916 WEST ADAMS SUITE 3
PHOENIX, AZ 85007

GREG PATTERSON, DIRECTOR

IN THE MATTER OF THE APPLICATIONS OF GLOBAL WATER--PALO VERDE UTILITIES COMPANY; VALENCIA WATER COMPANY--GREATER BUCKEYE DIVISION; WILLOW VALLEY WATER COMPANY; GLOBAL WATER-SANTA CRUZ WATER COMPANY; WATER UTILITY OF GREATER TONOPAH INC.; AND VALENCIA WATER COMPANY—TOWN DIVISION FOR PERMANENT BASE RATE INCREASES FOR WATER SERVICE

DOCKET NOS. SW-20445A-09-0077; W-02451A-09-0078; W-01732A-09-0079; W-20446A-09-0080; W-02450A-09-0081; AND W-01212A-09-0082

EXCEPTIONS TO RECOMMENDED OPINION AND ORDER

WATER UTILITIES ASSOCIATION OF ARIZONA'S EXCEPTIONS TO THE RECOMMENDED OPINION AND ORDER

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Introduction

The Water Utilities Association of Arizona is a non-profit corporation representing the investor-owned segment of the water industry in the state of Arizona. The association has a regular membership of approximately 50 investor-owned water companies, serving from a few to nearly 500,000 customers.

The WUAA participates in cases at the Arizona Corporation Commission to the extent that the issues presented affect WUAA members. Global Water is not a member of the WUAA; however, several of the issues presented in the Global case—Acquisition Adjustments, and Contributions in Aid of Construction--are common to WUAA members. These exceptions will only focus on the treatment of Contributions in Aid of Construction.

Contributions in Aid of Construction (CAIC) or (Contributions)

Accounting for Contributions has become one of the more difficult and controversial portions of rate cases. However, at its core, the Contributions or CAIC subtraction should be rather simple. But first, what is a Contribution and why would someone make a Contribution to a private water company? The answer, of course, is that if a developer wants to build a master planned community, he may not also want to build an entire water company. Meanwhile the nearest water company may not want to build a supply line all the way to the developer's project. The solution is simple; the developer builds the supply line and then donates it to the company. In addition to being simple and effective, this solution is also cheaper for the company and developer. That's why this type of transaction is common. However, this simple solution generates an accounting question. How should we account for the free supply line or other donated plant? After all, the supply line from the company to the new development is part of rate base--it's obviously an asset that the company now owns. However the company did not pay for the supply line. If the supply line—or any other asset contributed by a developer—remains in rate base then the company will receive a windfall. The company will be reimbursed for an asset that it did not pay for. The solution to this problems is the "CAIC Subtraction." The ACC should subtract the cost of the Contributed plant out of rate base to ensure that the company doesn't earn a return on plant that it didn't purchase. The purpose of removing Contributions from rate base is to eliminate the windfall that would inure to a company that was allowed to earn a return on an item of rate base for which the company did not actually pay[1]. If a developer contributes money to build, say, a well, then the well would have to be subtracted out of rate base in order to prevent the company from earning a return on a component of rate base that the company itself did not purchase.[2]

So if a portion of the company's rate base was either built by or paid for by a developer and then donated (contributed) to the water company, then it's fair to remove the cost of that item from rate base. Otherwise, the water company would be earning a return on an asset that it didn't buy.

But what happens if, for some reason, the item that was contributed to the water company was never put into rate base in the first place? What if the asset (pipe, supply line, well, treatment plant) is removed from rate base for another reason? What if the supply line isn't "used and useful", or was put in service after the test year and the Commission decides to remove it from rate base? If the supply line is removed from rate base because it isn't being used, does it matter that it was Contributed? Should we still make a subtraction in order to prevent a windfall? Of course not. If we subtract out the value of the Contribution from an asset that never went into rate base in the first place, then the second entry acts as a double count--instead of avoiding a windfall, the company incurs a penalty.[3]

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[1] Tr.(Jaress) 732:15-18
[2] Id. 732:14
[3] TR Rigsby 56:1-10

In Global's case the Contributions were used to purchase troubled companies whose Fair Market Value was higher than their book value. In order to place these acquired companies into rate base, the Commission would have to grant an Acquisition Adjustment for the difference between the Rate Base of the acquired company and its purchase price. The ACC has traditionally rejected such acquisition adjustments and Global chose not to even seek an acquisition adjustment.[4]

Therefore, since the items purchased with the money Contributed by the developers (premiums on troubled companies) were not placed into rate base then it would be an accounting error to simply subtract those Contributions from rate base. That's a critical point. How can Global somehow get a windfall from money Contributed by developers if the assets that Global purchased with that money were never put in rate base? The purpose of subtracting out Contributions is to REMOVE items from rate base—but these items were never in rate base. That means that if the ACC subtracts the amount of the Contributions from rate base (which the ROO proposes) then the Contributions will be removed twice; the rate base will be negative and the company will be punished for accepting the Contributions.

WUAA believes that RUCO Witness Rigsby in his Direct Testimony, provided the clearest articulation of the required analysis.

> *Based on RUCO's review of the ICFA's obtained through discovery, ICFA funds that are intended to provide utility plant that is used to serve new development should be treated as CIAC[5].*

Mr. Rigsby was correct when he said that the CAIC (Contribution) subtraction should only be made to Contributions that are "*intended to provide utility plant that is used to serve new*

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[4] Tr. (Hill)56:23
[5] Rigsby Direct at page 13 lines 18-21.

development." In other words, to the extent that the Contributions are in rate base, they should be subtracted so the company doesn't get a windfall. Mr. Rigsby's analysis is consistent with the testimony of both Staff and RUCO that the purpose of a CAIC (Contribution) subtraction is to prevent a windfall to the company.[6] Mr. Rigsby is providing the rationale for traditional CAIC or Contribution subtraction.

Unfortunately, Mr. Rigsby abandoned that position in his surrebuttal testimony. In justifying the switch, Mr. Rigsby focuses on the ICFAs which are a unique aspect of Global's financial structure, however, he fails to articulate why he dropped his requirement that the investment must have been "*intended to provide plant that is used to serve new development*".

WUAA believes that the original RUCO position is the correct one—Contributions should only be subtracted out to the extent that they were *"intended to provide utility plant that is used to serve new development."* RUCO's original analysis is consistent with the traditional theory that CAIC (Contribution) subtractions are made to prevent a windfall to the company. Unfortunately, this traditional accounting treatment—subtracting Contributions from rate base only to the extent that they were actually put into rate base—has been characterized in the ROO as some sort of departure from traditional ratemaking treatment. "Applicants request that the Commission put aside the normal regulatory ratemaking treatment of contributions that were given in exchange for utility service..."[7] Yet the "normal regulatory ratemaking treatment" of Contributions is to subtract them out of rate base in order to prevent a windfall. Naturally, that subtraction is limited to the actual amount that was put INTO rate base. Here, Global received Contributions from developers and spent the money buying failing water companies. Global never tried to get those acquisition expenses into rate base—so there is nothing to subtract out. There's no possibility of a windfall because Global never sought to put the Contributed assets into the rate base in the first place. Yet the ROO accepts Staff's suggestion that Contributions be somehow "imputed" to rate

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[6] TR (Rigsby) 571:4-10 and Tr. (Jaress) 732:15-18

[7] ROO page 29 line 17.

base. Imputed to rate base? That technique would require the ACC to put aside normal regulatory ratemaking treatment. That technique would remove items from rate base that are not even in rate base. That technique would result in a negative rate base. That technique would not eliminate a potential windfall, it would create a penalty. That technique would be objectively wrong from an accounting perspective.

Global water has stepped forward to provide a comprehensive solution to water management issues. The Company sought contributions from developers and used those contributions to purchase, consolidate and manage struggling water companies. Moreover, Global did not seek to place the cost of these acquisitions in rate base, so there was no chance that Global would receive a windfall return on these acquisitions. Nevertheless, the ROO adopts a non-traditional accounting technique that would subtract these Contributions out of rate base—even though they were never in rate base. The result—predictably—is that the company will be saddled with a negative rate base and will be penalized dollar-for-dollar on every dollar that developers contributed to enable Global to purchase these troubled companies and provide a comprehensive water management solution. The members of the Arizona Corporation Commission should reject this methodology and revert to the traditional treatment in which Contributions are subtracted out of rate base only to the extent that the assets purchased with the contributions were actually placed into rate base.

Respectfully submitted this 3rd day of August 2010

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